

DEPARTMENT OF STATE REVENUE

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Sales and Use Tax

For The Tax Periods: 1993 through 1995

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ISSUES

I. Sales/Use Tax - Manufacturing Exemption

Authority: IC 6-2.5-5-2; IC 6-2.5-5-1; 45 IAC 2.2-5-8; 45 IAC 2.2-5-6

Taxpayer protests the assessment of sales tax on its trucks it uses and fuel it consumes in transporting livestock between facilities it owns and facilities it leases.

STATEMENT OF FACTS

Taxpayer is engaged in the business of raising and processing ducks for human consumption. Taxpayer owns the entire flock of breeder ducks that produce the eggs that taxpayer uses. However, some breeder ducks are kept at farms that the taxpayer leases. Eighty-five percent (85%) of the eggs come from taxpayer owned breeder barns. The rest of the eggs are produced in breeder barns owned by others, but leased by taxpayer. The taxpayer moves the eggs from the breeder barns to hatcheries it owns, to incubate the eggs until the ducklings hatch. The taxpayer then moves the ducklings to growing barns for them to mature to marketability. Taxpayer owns only about eight percent (8%) of the growing barns, leasing the rest. However, while at the leased growing barns, the taxpayer maintains ownership of the ducks, produces and supplies all duck feed, maintains the health of the ducks with its own veterinarian, and provides supervision of the growing barn operations. When the ducks are mature and ready for market, taxpayer transports the ducks to its processing plant. At the processing plant, the ducks are slaughtered, dressed, the meat is frozen and the feathers packaged.

An audit in 1996 revealed, *inter alia*, that the taxpayer erroneously paid sales tax on trucks rented and diesel fuel for the trucks used to transport the ducks to the various farms. The Department's auditor allowed a refund on sales tax for the estimated use of the rental truck and fuel consumed to transport the ducks between facilities owned by the taxpayer. But the auditor did not allow a refund of the sales tax paid on the rental truck and fuel consumed to transport the ducks between facilities owned by the taxpayer and those it leases.

I. Sales/Use Tax – Agricultural Exemptions

Indiana law provides exemptions from sales and use tax for various transactions of retail merchants, including agricultural production. The agricultural exemption, like the manufacturing exemption, employs the venerable "double direct test". Because there is case law examining the double direct test used in other exemptions, the analysis applied in those cases is applicable to this matter arising under the agricultural exemption. See e.g. *Indiana Dep't of State Revenue v. American Dairy of Evansville, Inc.*, 338 N.E.2d 698 (App.Ind 1976). Exemption statutes are construed strictly against the taxpayer, *Indiana Dep't of State Revenue v. Cave Stone, Inc.*, 457 N.E.2d 520 (Ind.1983). However, a statute may not be so narrowly construed to defeat the legislature's intent for enacting them *Mechanics Laundry v. Ind. Dep't. of State Revenue*, 650 N.E.2d 1223 (Ind.Tax 1995). In order to obtain an exemption, taxpayer must show the equipment and consumables are an essential and integral part of the procedure by which a marketable product is produced, *Cave Stone* at 523. In making this determination, the production process is viewed as *continuous and indivisible*. *Cave Stone* at 524 (emphasis added).

Turning to the case at hand, the Department's auditor found the taxpayer's production process begins when the duck eggs are laid and ends with the prepared duck meat and feathers. The auditor also determined that the trucks used and fuel consumed to transport ducks between facilities owned by the taxpayer were part of the integrated process and were exempt. However, if the facilities that either received or sent the ducks was not owned by the taxpayer, but leased, then the auditor found it was outside the scope of the integrated process and the exemptions did not apply, even though no intermediate facility produced a marketable product. The ducks do not become marketable until they are dressed and frozen, and the feathers are washed and packaged at the taxpayer's plant. An integrated production process terminates not upon production of a potentially marketable product, but on the production of the most marketable product, *General Motors Corp. v. Ind. Dep't of State Revenue*, 587 N.E.2d 399 (Ind.Tax, 1991).

The facts of this matter show that the taxpayer controls the process from beginning to end with no differentiation in the process whether at a facility that the taxpayer owns or one it leases. This is due largely because the taxpayer maintains complete control of the process, materials and the product. Examples of this control show

that in all instances, the taxpayer owns the breeder ducks and the eggs produced at the breeder barns. Further, in all instances, the taxpayer owns the maturing ducklings, provides all feed, vaccinations and health care for the ducks, and provides operational supervision of the facilities. Additionally in all instances, taxpayer pays all insurance coverage and associated property taxes at each location. The taxpayer's methods, requirements and standards are identical at both types of facilities. There are only two differences between the taxpayer owned and taxpayer-leased facilities. First, the workers on the leased farms are not employees of taxpayer. Second, the lessee farmer must pay for medicines, produced by taxpayer, given to the ducks if the ducks are ill because of the lessee farmer operation.

A similar situation was presented to our tax court in *Energy Supply, Inc. v. Indiana Dep't of State Revenue*, 549 N.E.2d 1110 (Ind.Tax 1990). Energy Supply, Inc. used truck and consumed fuel to move coal from its mines to a processing plant that it did not own, but operated. The tax court examined, *inter alia*, the manufacturing process used to transform the raw materials into marketable product. The facts in *Energy Supply, supra*, showed that Energy Supply's employees were in control of supervising the production plant, the coal remained Energy supply's property, and the coal was not a finished product until it left the plant. Based on the its analysis, the tax court found that the truck were part of an integrated process, including the leased processing plant. Although, the Energy Supply matter came before the court on a motion for injunction and as such, it may not be precedential, it is, however, persuasive in this matter. Therefore, based on the facts of this matter and aided by *Energy Supply, Inc., supra*, it is clear that taxpayer controls the continuous integrated production process regardless of the facility in which it occurs.

FINDINGS

Taxpayer's protest is sustained.